No. 18,904

United States Court of Appeals

For the Ninth Circuit

MARINE MIDLAND TRUST COMPANY, etc., et al.,
Appellants,

vs.

CITY OF NORTH SACRAMENTO, etc.,
Appellee.

CITY OF NORTH SACRAMENTO, a municipal corporation,
Appellant,

vs.

MARINE MIDLAND TRUST COMPANY, etc., et al.,
Appellees.

ANSWERING BRIEF OF MARINE MIDLAND TRUST COMPANY, ET AL., RESPONDING TO CROSS APPEAL OF CITY OF NORTH SACRAMENTO

WILKE, FLEURY & SAPUNOR,
926 J Building, Suite 622,
Sacramento 14, California,

GALLOP, CLIMENKO & GOULD,
360 Lexington Avenue,
New York 17, New York,

Attorneys for The Marine Midland Trust Company of New York and John R. McGinley, as Trustees under a certain Indenture of Mortgage and Deed of Trust, dated as of the 1st day of March, 1947.

PERNAU-WALSH PRINTING CO., SAN FRANCISCO, CALIFORNIA

Subject Index

Table of Authorities Cited

Cases Pages

Codes

Statutes

Texts

No. 18,904

United States Court of Appeals
For the Ninth Circuit

MARINE MIDLAND TRUST COMPANY, etc., et al., *Appellants,* vs. CITY OF NORTH SACRAMENTO, etc., *Appellee.*	
CITY OF NORTH SACRAMENTO, a municipal corporation, *Appellant,* vs. MARINE MIDLAND TRUST COMPANY, etc., et al., *Appellees.*	

ANSWERING BRIEF OF MARINE MIDLAND TRUST COMPANY, ET AL., RESPONDING TO CROSS APPEAL OF CITY OF NORTH SACRAMENTO

STATEMENT

Upon motion by the City of North Sacramento (hereinafter "Defendant City"), the United States District Court for the Northern District of California (Halbert, J.) entered judgment (TR 57) dis-

missing the complaint herein. An appeal has been taken from such judgment of dismissal by Marine Midland Trust Company (hereinafter "Plaintiff Marine Midland") and the other Plaintiffs, the cross-appellees herein (hereinafter all collectively referred to as "Plaintiffs").

Following the aforesaid dismissal of the Complaint, Defendant City moved for costs and for leave to file a counterclaim, which motion was denied. Defendant City of North Sacramento takes the instant cross appeal from the order denying its motion for costs and for leave to file a counterclaim against Plaintiffs for expenses resulting to Defendant City from the prosecution of the instant action by Plaintiffs.

Defendant City purportedly invoked the appellate jurisdiction of this Court pursuant to 28 U.S.C. § 1291.

STATEMENT OF THE CASE

The principal relief sought in the Complaint herein was a declaratory judgment concerning a sum of money now on deposit with the Clerk of the Superior Court of the State of California in and for the County of Sacramento (TR 23).

Said money had been deposited following the sale to The First Boston Corporation and Associates by Defendant City of Water Revenue Bonds to finance the acquisition of a water system owned by Citizens Utilities Company of California. Pursuant to an Indenture of Mortgage and Deed of Trust, Plaintiff Ma-

rine Midland would have been the recipient of such funds. However, various misrepresentations detailed in the Complaint and in Plaintiffs' brief on their appeal from the portion of the judgment dismissing the Complaint had been made to The First Boston Corporation and Associates, the purchaser of the Water Revenue Bonds, and their subsequent transferees, as a result of which it and its transferees may have rights of action against Defendant City for rescission of the bond purchases, for damages and otherwise. By the same token, the money received by the Defendant City from the defrauded bond purchaser was money burdened with these claims—tainted money. By reason of Plaintiffs' knowledge of the circumstances of Defendant City's obtaining that money, if Plaintiffs were to take or receive that money, they would subject themselves to liability therefor if actions were to be commenced by the aggrieved parties.

Accordingly, rather than take money affected by outstanding claims—tainted money—and thereby subject themselves to various forms of suits, Plaintiffs sought a declaratory judgment adjudicating the rights and obligations of the parties and specifically that the money on deposit in the Superior Court of the State of California is not money which can be tendered in payment of the obligation which it purports to discharge, by reason of its tainted nature.

Defendants first moved for summary judgment which motion was denied. The District Court thereafter entered judgment dismissing Plaintiffs' Com-

plaint herein after receiving a total of ten briefs concerning the issues raised thereby, seven submitted by Defendant City and three by Plaintiffs (TR 91-93), and after an unusual opinion requesting further briefing (TR 43-46) in connection with points which Defendant City had failed to discuss.

In the opinion dismissing the Complaint (TR 47-54), the District Court did not rely on any failure of the Complaint to state a meritorious cause of action but held merely that Plaintiffs were required to seek relief in the State Court.

It was in this context that the Court denied Defendant City's motions for leave to file a counterclaim pursuant to Rules 13(e) and 15(a) for recovery of its expenses and costs.

POINT I

THE DISTRICT COURT PROPERLY DENIED DEFENDANT CITY'S MOTION FOR LEAVE TO FILE A COUNTERCLAIM.

Defendant City attempted to assert its supposed counterclaim approximately 10 days after the District Court handed down its opinion dismissing the Complaint essentially on the ground that the action had been brought in the wrong forum. Defendant City's counterclaim purportedly arose under § 526b of the California Code of Civil Procedure, which provides as follows:

> "Every person or corporation bringing, instigating, exciting or abetting, any suit to obtain an injunction, restraining or enjoining the issuance, sale, offering for sale, or delivery, of bonds, or

other securities, or the expenditure of the proceeds of the sale of such bonds or other securities, of any city, city and county, town, county, or other district organized under the laws of this State, or any other political subdivision of this State, proposed to be issued, sold, offered for sale or delivered by such city, city and county, town, county, district or other political subdivision, for the purpose of acquiring, constructing, completing, improving or extending water works, electric works, gas works or other public utility works or property, shall, if the injunction sought is finally denied, and if such person or corporation owns, controls, or is operating or interested in, a public utility business of the same nature as that for which such bonds or other securities are proposed to be issued, sold, offered for sale, or delivered, be liable to the defendant for all costs, damages and necessary expenses resulting to such defendant by reason of the filing of such suit."

It clearly appears from the discussion herein that the motion was properly denied for the following reasons, each of which is independently sufficient to sustain the District Court's decision:

(1) The supposed counterclaim (assuming arguendo that one could ever be asserted on this state of facts) had not yet matured because it had not been finally determined that Plaintiffs were not entitled to the relief they sought in this action; all that had been decided was that the District Court was not the proper forum to obtain such relief.

(2) No counterclaim could ever arise in favor of Defendant City against Plaintiffs under § 526b, C.C.P. because:

(a) The relief sought by Plaintiffs was merely declaratory, not the injunctive relief required by the statute;

(b) The securities issued by Defendant City for the purpose of acquiring the waterworks had already been issued before institution of Plaintiffs' action and thus the instant action could not possibly be construed as a suit to enjoin such a bond issue;

(c) Plaintiffs are not a private utility and therefore, pursuant to the California Supreme Court's construction of this statute, are not within its ambit; and

(d) The relief sought by Plaintiffs has not finally been denied, as is required under the statute.

A. The Supposed Counterclaim Could in No Event Be Deemed to Have Matured.

Rule 13(e) of the Federal Rules of Civil Procedure under which Defendant City seeks leave to file its purported counterclaim provides:

> "Counterclaim Maturing or Acquired After Pleading. A claim which either matured or was acquired by the pleader after serving his pleading may, with the permission of the court, be presented as a counterclaim by supplemental pleading."

"Of course," as stated in 3 *Moore's Federal Practice* (2nd ed. 1953), ¶13.32 at p. 85, "the counterclaim must have 'matured' before it can be pleaded under

Rule 13(e) even with the permission of the court." And it is well established that "[p]leading a claim for damages arising from the wrongful bringing of an action before the final determination thereof is premature and unauthorized by the Rules of Civil Procedure." *Goodyear Tire & Rubber Co. v. Marbon Corporation,* 32 F. Supp. 279, 280 (D.Del. 1940).

Accord:

Merz v. Merz White Way Tours, 166 F. Supp. 601, 602 (E.D. Pa. 1958);

Cyclotherm Corporation v. Miller, 11 F.R.D. 88, 89 (W.D. Pa. 1950);

Bach v. Quigan, 5 F.R.D. 34 (E.D.N.Y. 1945).

The hastiest perusal of the District Court's opinion herein shows that there has been no "final" determination on the merits in favor of defendant City and against Plaintiffs in this action. The District Court merely held that the Court in which the action was brought was the incorrect forum and that Plaintiffs were "required to intervene" in the proceedings in the state Courts (TR 54). This determination, although final for purposes of review by this Court, is obviously not a final determination of Plaintiffs' claim since even if the District Court's holdings on the issues appealed by Plaintiffs are upheld, Plaintiffs will merely be required to resort to the state courts.*

**A fortiori,* if this Court accepts Plaintiffs' contentions in the main appeal and holds that the Federal District Court must entertain this action, the District Court's action in denying Defendant City leave to file its counterclaim under C.C.P. 526b must be upheld since there has in that event been no final determination against Plaintiffs.

Likewise, under C.C.P. § 526b quoted in Defendant City's brief, no cause of action exists on behalf of Defendant City for expenses incurred in defense against Plaintiffs' suit unless and until the relief sought "is finally denied." In this connection, the California Supreme Court stated in *Sacramento M.U. District v. P.G. & E. Co.,* 20 Cal. 2d 684 (1942) (at p. 694):

> "The section establishes as a prerequisite to the recovery of those expenses that the private utility be unsuccessful thus indicating that its action was without legal foundation."

In the instant case, the District Court did not finally deny the relief sought or indicate that it considered Plaintiff's action to be non-meritorious. That Court merely required Plaintiff to seek its remedy in another forum. It is perfectly possible (if this Court upholds the District Court's determination appealed from by Plaintiffs) that Plaintiffs will intervene in the state Court proceedings and there obtain the relief they were unable to secure in the federal Court. Surely, under such circumstances it would be anomalous for Plaintiffs to be faced with a counterclaim such as this in the Federal District Court.

The requirement of maturity of counterclaims of Rule 13(e) is designed to prevent just such situations, and such requirement is ample basis for sustaining the portion of the District Court's judgment here at issue.

B. California Code of Civil Procedure § 526b Does Not Permit of a Counterclaim Under the Facts of This Case.

The District Court's determination denying leave to counterclaim should also be affirmed because Defendant City has no counterclaim as a matter of state law. Its purported counterclaim was clearly barred by any one of four separate requirements of the statute.

First, as Defendant City admits (Br. p. 7), the relief sought by Plaintiffs herein is declaratory. Since the statute creates a cause of action for expenses resulting from a suit against a city "to obtain an injunction," it is obvious that Defendant City has no cause of action here.

Second, and similarly, the statute only creates a cause of action if "bonds or other securities are proposed to be issued, sold, offered for sale or delivered" by a city for the acquisition of a public utility. In the instant case, the securities issued by Defendant City for the purpose of acquiring the waterworks which previously was owned by Citizens Utilities Company of California had already been issued, offered for sale, sold and delivered to The First Boston Corp. and Associates at the time of the institution of this suit (TR 12-14). A suit against the Defendant City at this stage no longer is covered by the statute.

The reason for the limited statutory coverage was given by the California Supreme Court in *Sacramento M.U. District v. P.G. & E. Co., supra,* at p. 694. The Court there stated that the purpose of the

statute was to discourage litigation by private utilities designed "to hamper and interfere with the development and operation of a public utility by a public agency, and thus either delay or forestall the day when its business would be wholly or partially destroyed by such threatened competition." This suit in no way forestalls or delays the acquisition or operation of the water system by Defendant City. The entire water system has been acquired by Defendant City, is in the possession of Defendant City, and is being operated by Defendant City (TR 20). Bonds for its acquisition have been issued, offered for sale, sold and delivered to First Boston Corp. and Associates (TR 12-14) without any attempt to enjoin such distribution. The bringing of this suit for a declaratory judgment, after all of the above events, offends no state policy and is plainly not covered by the language of the statute.

Third, the statute only creates a cause of action against a person or corporation who "owns, controls or is operating or interested in a public utility business of the same nature as that for which such bonds or other securities are proposed to be issued." The Supreme Court of California interpreting these words has stated that this language includes "only private utilities and such of those as operate within the area embraced by the public agency." *Sacramento M.U. District v. P.G. & E. Co., supra,* at p. 694. Marine Midland, against whom Defendant City seeks to interpose its counterclaim, is a lending institution and not a private utility (TR 1), nor is there the slightest

indication in the Record that any of the Plaintiffs control or operate private utilities. Plaintiffs' only connection with private utilities such as Citizens Utilities Company of California concerns Marine Midland's activities as a lender of money (TR 1-25). The statute does not give a city a cause of action against such a party.

Fourth, the statute only establishes a cause of action based on the improper institution of suit if the relief sought in such suit "is finally denied". As shown above, there has been no final denial of the relief sought by Plaintiffs, but merely a holding that they must repair to the state Court for a decision on the merits of their claim.

Moreover, even if there were any doubt whether a counterclaim against Plaintiffs is warranted by § 526b, and we submit there is not, the statute would have to be construed strictly in favor of Plaintiffs and against Defendant City. California C.C.P. § 526b, in creating a cause of action for attorneys' fees and other expenses resulting from litigation, establishes a penalty for the institution of baseless legal actions. *Marshall v. Foote,* 81 Cal. App. 98 (1st Dist. 1927). It has long been the rule in California that such statutes must be narrowly construed, the presumption being against the party seeking to enforce a penalty. In *Thompson v. San Francisco Gas & Electric Co.,* 20 C.A. 142 (1st Dist. 1921), the Court stated (p. 144):

> "Penalties are never favored either by courts of law or equity. Every intendment and presump-

> tion is against the person seeking to enforce the penalty or forfeiture provided by such a statute."

And the California Supreme Court stated in *Weber v. Pinyan,* 9 Cal. 2d 226, 229 (1937):

> "A statute creating a new liability or increasing an existing liability, or even a remedial statute giving a remedy against a party who would not otherwise be liable, must be strictly construed in favor of the persons sought to be subjected to their operation."

Accord:

Jones v. Allen, 185 C.A.2d 278, 281 (2d Dist. 1960);

Cantlay & Tanzola, Inc. v. Ingels, 31 C.A.2d 553, 556 (2d Dist. 1939);

Benbaugh Mortuary v. Barney, 196 C.A.2d 861, 864 (App. Dep't, Sup. Ct. 1961).

For all of the above reasons, the District Court not only soundly exercised its discretion by denying defendant City's motion for leave to file a counterclaim under the statute, but was obliged to deny said motion as a matter of law.

POINT II

THE DISTRICT COURT'S DENIAL OF COSTS TO DEFENDANT CITY WAS A SOUND EXERCISE OF ITS DISCRETION UNDER RULE 54(d), F.R.C.P.

Rule 54(d) of the Federal Rules of Civil Procedure, which governs the awarding of costs in suits such as the present, has "adopted for all suits covered

by it, the previous federal practice in equity according to which the trial court had wide discretion in fixing costs, a discretion not reviewable unless manifestly abused. . . ." *Harris v. Twentieth Century Fox Film Corporation,* 139 F.2d 571, 572 n. 1 (2nd Cir. 1943); see generally, 6 *Moore's Federal Practice,* ¶54.70[3] and cases therein cited.

The former equity rule, now governing all cases subject to the federal rules, was stated as follows in the leading case of *Bliss v. Anaconda Copper Mining Co.,* 167 F. 1024, 1028 (C.C.D. Mont. 1909):

> "The usual rule in equity is that the party found entitled should be reimbursed the expense of defending his rights. It is, however, a recognized doctrine that costs in equitable suits are subject to the sound judicial discretion of the court, and, where it appears that complainant had good reason to think the defendant was liable upon equitable principles, the court does not necessarily award costs against him, but may ascertain what sound discretion requires to be done under the facts of the case. It can be said that the questions involved in this litigation were not thoroughly well settled when this complainant brought his suit. There was wide room for difference of opinion. * * *
>
> "Upon careful consideration, I conclude that it is equitable that each party shall pay his and their own costs."

And this Court, quoting the United States Supreme Court, stated in *Alameda v. Parafine Companies,* 169 F.2d 409, 410 (9th Cir. 1948):

> "The Supreme Court has said of costs that 'Their allowance to the prevailing party is not, moreover, a rigid rule. Under the Federal Rules of Civil Procedure * * * the court can direct otherwise. Rule 54(d).' Fishgold v. Sullivan Corp., 328 U.S. 275, 284, 66 S.Ct. 1105, 1110, 90 L.Ed. 1230, 167 A.L.R. 110. Cf. Truth Seeker Co. v. Durning, 2 Cir., 147 F.2d 54; Shima v. Brown, 78 U.S. App. D.C. 268, 140 F.2d 337."

The Record on Appeal herein discloses that the District Court's refusal to tax defendants with costs was fully warranted. Prior to the District Court's decision on the motion appealed by Plaintiffs in the principal appeal herein, defendants had unsuccessfully attempted to secure dismissal of Plaintiffs' cause of action. In September 1962, defendants first moved for summary judgment and secured a stay of taking of depositions pending decision of such motion (TR 91). On November 19, 1962, the District Court denied defendants' motion for summary judgment holding that there were "certain material issues of fact as to the merits of this action which are in dispute" (TR 39-40). Thereafter, in December defendants filed their notice of motion to dismiss and/or for judgment on the pleadings (TR 92). Defendants submitted an opening memorandum, Plaintiffs filed a memorandum of law in opposition, and Defendants filed a reply memorandum (TR 92-93). The Court, however, not satisfied with the issues raised by defendants, found it necessary to request "further briefing" and to allude to specific points as to which it required clarification. Two further briefs were

submitted by Defendants and one by Plaintiffs (TR 93). Only thereafter, did the District Court enter judgment dismissing the Complaint (TR 47-54). Plainly, the District Court was of the opinion that Plaintiffs herein "had good reason to think the defendant was liable upon equitable principles." *Bliss v. Anaconda Mining Co., supra.*

Moreover, the District Court did not consider or in any way question the merits of Plaintiffs' cause of action. On the contrary, the District Court referred Plaintiffs to the state Court for their remedy. Under these circumstances, although defendants may be the "prevailing party" in a technical sense, they are certainly not yet the prevailing party in the controversy between the parties. Regarding such controversy, Plaintiffs have not yet had a day in Court.

Under these circumstances, and in light of the District Court's intimate knowledge of the history of this litigation, it is submitted that there has been no such "manifest abuse" of discretion as to require this Court to overturn the District Court's denial of costs to Defendants.

CONCLUSION

The judgment below insofar as it denied Defendant City costs and leave to file a counterclaim should be affrmed.

Dated, Sacramento, California,
January 15, 1964.

Respectfully submitted,
WILKE, FLEURY & SAPUNOR,
GALLOP, CLIMENKO & GOULD,
Attorneys for The Marine Midland Trust Company of New York and John R. McGinley, as Trustees under a certain Indenture of Mortgage and Deed of Trust, dated as of the 1st day of March, 1947.

CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those Rules.

WILKE, FLEURY & SAPUNOR,
By JOHN M. SAPUNOR.